Alberta Capital Finance Authority

2005 ANNUAL REPORT

Contents

DIRECTORS

BOARD OF DIRECTORS

Appointed
D.H. Bader
C.F. Barth
F.W. Clarke
L.R. Gordon
B.F. Manning

Elected
H.N. Johnsrude
- Representing Class B shareholders

E.A. Gibbons
- Representing Class C shareholders

L.G. Mann
- Representing Class D shareholders

D.O. Lussier
- Representing Class E shareholders

OFFICERS

D.O. Lussier
- Chair of the Board

H.N. Johnsrude
- Vice-Chair

T.S. Stroich
- President and Treasurer

L. Epp
- Vice-President

J. Hui
- Corporate Secretary and Assistant Treasurer

For more information, visit our website or contact the Alberta Capital Finance Authority Office

2450 Canadian Western Bank Place
10303 Jasper Avenue
EDMONTON, Alberta
T5J 3N6

Phone (780) 427-9711
Fax (780) 422-2175
Website http://www.acfa.gov.ab.ca
E-mail webacfa@gov.ab.ca

ORGANIZATION

Mission

To provide local authorities within the Province with flexible funding for capital projects at the lowest possible cost, consistent with the viability of the Alberta Capital Finance Authority.

Authority

The Alberta Capital Finance Authority is a non-profit Authority established in 1956 under the authority of the *Alberta Capital Finance Authority Act*, Chapter A-14.5, Revised Statutes of Alberta 2000, as amended.

Shareholders

The authorized stock of the Authority consists of the following shares with a par value of $10 each:

- 4,500 Class A, available only to the Crown
- 1,000 Class B, available only to municipal authorities (defined as including improvement districts, metis settlements, municipal districts, counties, special areas, and specialized municipalities) and to regional authorities (includes drainage districts, irrigation districts, regional airport authorities and regional services commissions), and health authorities (includes approved hospitals, mental health hospitals, regional health authorities, and provincial health boards)
- 750 Class C, available only to cities
- 750 Class D, available only to towns and villages
- 500 Class E, available only to educational authorities (includes school districts and divisions, colleges, technical institutes, universities and Northland School Division)

The business of the Authority is administered by a Board of Directors. The Lieutenant Governor in Council appoints up to five directors to represent the Class A common shareholder. Each of the other four classes of shareholders elects one director to the Board.

Loans

Maximum terms of loans for various projects are prescribed in the Authority's resolution relating to the terms and conditions for lending money to shareholders.

Financing

The Authority issues various debt obligations to obtain the funds necessary to finance loan requirements. These obligations of the Authority carry the unconditional guarantee of the Province of Alberta.

Chair's Report

February 23, 2006

It is my privilege and pleasure to present the 49th Annual Report of the Alberta Capital Finance Authority for the year ended December 31, 2005, and to review its activities over the past year.

The Authority has completed 49 years of service to Albertans and celebrates its 50th Anniversary on March 29, 2006, fifty years to the day when legislation establishing the Authority was proclaimed. I invite all of you to our special annual meeting and lunch celebrating the Authority's service to Albertans.

ACFA was created in 1956 to help local governments, especially smaller entities, access capital markets at more favourable rates without the substantial costs associated with, nor the considerable costs in the administration related to the ongoing monitoring, of such borrowings. Fifty years later, ACFA's mission is much the same *"To provide local authorities within the Province with flexible funding for capital projects at the lowest possible costs, consistent with the viability of the Authority."*

I am proud and honoured to be associated with the Authority which has been able to provide a continuing high level of service and benefits to all Albertans. It is said that the best things come in small packages, and the Authority with its dedication to service and fairness to its shareholders, has proved this point to the extreme.

To provide you with greater detail about the past 50 years, included in the Authority's Annual Report is an overview describing the activities of the past 50 years. I will focus the balance of my report on the activities for the year ended December 31, 2005.

As noted in my report last year, the Authority continued to issue loans under its new lending policies that were to remain in effect for a two year trial period ending in 2005. These new lending policies were reviewed by the Board in late 2005, and it was agreed that they should continue as they meet the needs of our borrowers while maintaining the financial viability of the Authority. These new policies however will have an impact on administration, increasing staff work load and costs because of the need for new systems and procedures. The Authority will still meet its goal of being the lowest cost provider. In February 2005, the Authority was able to eliminate the 6 basis points which had been added to interest rates to help cover increasing administration costs which it had put into place in January 2004.

The past year was a very busy one for the Authority and saw over $652 million in new loans issued, an increase of over $45 million over 2004. The Authority issued its second 30-year loan in 2005, a loan for a student residence in southern Alberta.

Interest rates remained at nearly historical lows with short-term rates, 3 and 5-year terms, fluctuating between 3.2% and 4.0% during the year and long-term rates, 20 and 25-year terms, decreasing to under 4.5% in mid year and then increasing only moderately to the end of the year, remaining under 5.0%.

The Authority's goal is to operate on a break-even basis with a minimum level of retained earnings and this year had budgeted for a loss of $3.0 million. During the year the Authority was able to achieve very attractive funding levels and was able to reduce its net interest expense by over $2.0 million, reducing the net loss to $1.0 million.

The Board has seen further changes in 2005 with the addition of Lorne Mann representing the Class "D" shareholders and the retirement of Steve Burford who served on the Board for 3-years. In addition to Steve, Harold Johnsrude the current Vice-Chair and 6-year Board member has announced that he will also step down in early 2006 and I would like to thank each of them for their dedication and service to the Authority.

I wish to thank the rest of the Board members for their dedication and support of the Authority's mission, and their skill in addressing the issues coming before the Board. I would also like to recognize and acknowledge the staff for their efforts and commitment in providing our shareholders and Board with outstanding service over the past year.

As I mentioned before, it is an honour and privilege to serve as Chair of this very successful and committed organization which has served Albertans for 50-years and look forward to continuing its tradition of providing low cost flexible financing for our shareholders.

[Original Signed]

Don Lussier
Chair

The following provides management's analysis of the financial position and results of operations of the Alberta Capital Finance Authority for the year ended December 31, 2005.

Loans

During 2005, the Authority loan portfolio increased from $4,150 million to $4,301 million, an increase of $151 million. New loans issued during the year totalled $652 million, an increase of $45 million from new loans issued in 2004 and loan repayments totalled $501 million. The Authority is forecasting that loan demand will be strong over the next few years, with increasing demands by the educational, municipal and health sectors. Included in this review is an Analysis of New Loans Issued in 2005 by Jurisdiction and Purpose, a Schedule of Loans Outstanding at December 31, 2005, and the Ten-Year Loan Review 1996-2005.

Analysis of New Loans Issued

By jurisdiction and purpose for the year ended December 31, 2005
(thousands of dollars)

	Cities	Towns	Villages	Other	Total
Sewer and water	$ 194,218	$ 12,940	$ 897	$ 46,201	$ 254,256
Student residences, parkade and ancillary operation	–	–	–	82,998	82,998
Airport infrastructure	–	–	–	75,000	75,000
Roads and sidewalks	66,055	5,876	390	1,250	73,571
Health - ancillary operation	–	–	–	37,920	37,920
Parks and recreation	16,067	17,050	300	2,408	35,825
Municipal buildings	28,578	2,449	100	1,747	32,874
Transit	22,305	–	–	–	22,305
Equipment and machinery	17,015	1,762	–	1,445	20,222
ME *first!*	5,930	2,170	70	1,008	9,178
Public housing	3,797	–	–	–	3,797
Land	–	215	–	991	1,206
Electric utilities	1,200	–	–	–	1,200
Landfill development	185	–	–	700	885
Irrigation	–	–	–	700	700
Total	**$ 355,350**	**$ 42,462**	**$ 1,757**	**$ 252,368**	**$ 651,937**

Schedule of Loans Outstanding
as at December 31, 2005
(thousands of dollars)

	Principal Outstanding 31-Dec-04	2-Jan-05 to 31-Dec-05 New Loans Issued	Principal Repaid	Principal Outstanding 31-Dec-05
By Jurisdiction				
Cities	$ 2,444,984	$ 355,350	$ 265,004	$ 2,535,330
Specialized Municipalities	139,887	6,794	10,954	135,727
Towns	228,880	42,462	23,628	247,714
Villages	9,610	1,757	1,450	9,917
Counties	70,204	20,436	5,785	84,855
Municipal Districts	16,304	2,919	1,826	17,397
Irrigation Districts & Regional Services Commissions	67,198	26,301	4,395	89,104
Regional Airport Authorities	390,000	75,000	75,000	390,000
Health Authorities	27,086	37,920	843	64,163
Colleges, Technical Institutes & Universities	275,604	82,998	39,233	319,369
School Districts & Divisions	480,448	–	72,707	407,741
	$ 4,150,205	**$ 651,937**	**$ 500,825**	**$ 4,301,317**
By Purpose				
Municipal - General	$ 2,446,154	$ 445,641	$ 264,267	$ 2,627,528
Municipal - Utility	523,640	1,200	46,543	478,297
ME *first!*	5,536	9,178	1,736	12,978
Airport Infrastructure	390,000	75,000	75,000	390,000
Health - Ancillary Operation	28,424	37,920	1,317	65,027
Student Residence, Parkade and Ancillary Operation	275,604	82,998	39,233	319,369
School - Core Operation	480,847	–	72,729	408,118
	$ 4,150,205	**$ 651,937**	**$ 500,825**	**$ 4,301,317**

Ten-Year Loan Review 1996-2005
(thousands of dollars)

	2005	2004	2003
New loans issued during the year:			
By jurisdiction:			
Cities	$ 355,350	$ 377,445	$ 379,647
Specialized municipalities	6,794	15,115	26,830
Towns and villages	44,219	53,569	31,122
Counties, municipal and irrigation districts, and regional services commissions	49,656	43,542	40,056
Regional airport authorities	75,000	20,000	–
Health authorities	37,920	19,000	–
Colleges, technical institutes and universities	82,998	71,112	19,302
School districts and divisions	–	7,680	–
Total	**$ 651,937**	**$ 607,463**	**$ 496,957**
By purpose:			
Municipal	$ 446,841	$ 484,135	$ 477,655
ME *first!*	9,178	5,536	–
Airport infrastructure	75,000	20,000	–
Health – ancillary operation	37,920	19,000	–
Student residence, parkade and ancillary operation	82,998	71,112	19,302
School – core operation	–	7,680	–
Total	**$ 651,937**	**$ 607,463**	**$ 496,957**
Loans repaid during year	500,825	397,916	410,372
Loans outstanding at December 31	4,301,317	4,150,205	3,940,658
New debt issued during year (at par)	972,000	714,500	3,137,000
Debt repaid during year	832,604	475,491	2,930,523
Debt outstanding at December 31	4,355,963	4,216,567	3,977,558
Sinking fund investments at December 31	–	–	–
Retained earnings at December 31	11,673	12,664	22,406
Lending rate at December 31 *(based on 20-year term)*	4.569%	4.923%	5.625%

2002	2001	2000	1999	1998	1997	1996
$ 255,139	$ 297,004	$ 226,820	$ 157,516	$ 115,738	$ 137,631	$ 104,949
17,742	13,133	38,741	20,226	10,233	5,906	1,376
20,211	25,657	29,726	24,044	16,268	15,025	11,486
10,489	9,449	2,815	14,431	2,785	3,816	898
370,000	–	–	–	–	–	–
–	–	–	–	10,000	–	–
91,300	17,825	66,300	17,975	–	–	–
1,260	271	5,033	2,294	5,080	2,246	1,400
$ 766,141	**$ 363,339**	**$ 369,435**	**$ 236,486**	**$ 160,104**	**$ 164,624**	**$ 120,109**
$ 303,581	$ 345,243	$ 298,102	$ 215,967	$ 144,774	$ 162,378	$ 118,709
–	–	–	–	–	–	–
370,000	–	–	–	–	–	–
–	–	–	–	10,000	–	–
91,300	17,825	66,300	17,975	–	–	–
1,260	271	5,033	2,544	5,330	2,246	1,400
$ 766,141	**$ 363,339**	**$ 369,435**	**$ 236,486**	**$ 160,104**	**$ 164,624**	**$ 120,109**
418,565	456,062	427,095	422,002	562,723	495,961	447,310
3,854,073	3,506,497	3,599,220	3,656,880	3,842,396	4,245,015	4,576,352
2,280,000	725,000	592,367	–	–	–	60,000
1,929,735	776,739	1,002,367	294,206	226,645	175,457	266,685
3,771,081	3,420,816	3,472,555	3,882,555	4,176,761	4,403,406	4,578,863
–	–	–	450,153	417,639	385,304	345,764
26,676	132,738	149,913	275,656	318,602	333,505	312,211
5.875%	6.000%	6.125%	6.500%	5.625%	6.000%	6.875%

Results of Operations

The Authority's interest expense on debt exceeded interest income on loans, including amortization and income from investments, by $90 thousand as the yield on the loans was slightly lower than the yield on the debt. This net interest expense of $90 thousand was reduced by $66 thousand in loan prepayment fees, and with other expenses of $967 thousand, resulted in a loss of $991 thousand for 2005.

The Authority's goals are to provide local authorities with flexible funding at the lowest possible cost and to maintain the lowest administrative and new loan costs compared to other municipal borrowing authorities. Included is a comparison of the Authority's 2005 costs with the latest audited financial data of other provincial municipal borrowing authorities.

Capital Finance Authority Statistics - 2005

	Alberta	British Columbia	Nova Scotia
New loans to shareholders *($ millions)*	652	703	168
Total loans outstanding *($ millions)*	4,293	3,475	671
Administrative expense			
($ thousands)	967	1,440	314
($ per $ thousand of new loans)	1.48	2.05	1.87
($ per $ million of loans)	.23	.41	.47

Interest Rates

The Authority provides fixed rate semi-annual pay amortizing loans to its borrowers. Loan rates are based on actual rates for the interest rate swaps (or other floating rate instruments) executed to convert the loan to a floating rate to match the funding floating rate in order to reduce interest rate risk to the Authority. If a fixed rate instrument is used to fund the loan, then the loan rate will be based on the actual rate of the fixed rate instrument.

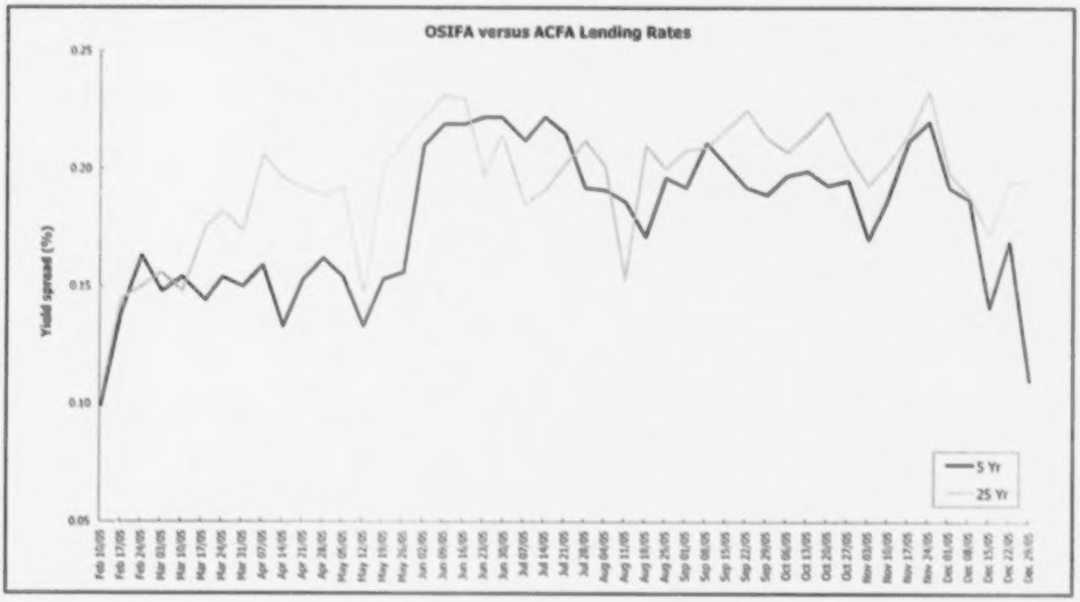
In 2004 a fee of 6 basis points was added to each loan rate, regardless of the duration of the loan to account for the following expenses:

- 2 basis points to cover the Authority's expenses to administer the loan program
- 4 basis points to recover financing commissions/fees; applied on a broad-basis to all loans, regardless of the loan term and funding decision employed on a particular borrowing date

As the Authority was able to achieve lower interest rates on its debt as anticipated, the 6 basis points was deleted for all loans made after February 18, 2005.

Comparative Loan Spreads with Other Municipal Borrowers

In order to compare the Authority's loan rates provided to those of other municipal borrowers, rates of the Ontario Strategic Infrastructure Financing Authority (OSIFA) were reviewed and compared to the rate that the Authority would have offered. As noted below ACFA's rates were consistently below OSIFA's throughout the year. Lending rates for OSIFA's 5 and 25-year loans were 10 to 23 basis points above ACFA's rates. The Authority's goal is to provide the lowest rate for Alberta borrowers.



Debt

The gross debt of the Authority increased by $139 million to $4,356 million. During the year, the Authority received $501 million in loan repayments while issuing $652 million in new loans. The Authority repaid $284 million to the Canada Pension Plan Investment Fund and $387 million under the Public Promissory Note Program. During the year the Authority borrowed $810 million in medium and long-term debt for terms from 5 to 20-years and to meet short-term requirements, borrowed over $162 million, all of which was repaid during the year.

Sources of Capital
(thousands of dollars)

	Gross Outstanding December 31, 2005	Outstanding as a Percentage of Total
Canada Pension Plan Investment Fund	$ 1,920,963	44.1%
Public	2,435,000	55.9%
Total	$ 4,355,963	100.0%

Risk Management

Effective risk management is central to the ability to ensure a financially sound organization and includes identifying, assessing, managing and monitoring all forms of risk. The Authority is primarily exposed to:

- Market risk
- Liquidity risk
- Operational risk and
- Credit risk

The President of the Authority is responsible for identifying risks and recommending the appropriate policies and framework. The Board of Directors reviews and approves the risk management policies and implements specific reporting procedures to enable them to monitor the adherence to these policies.

Market Risk

Market risk is the impact on the Authority's income from changes in market factors such as interest rates and foreign exchange. The Authority requires that all borrowing be done in Canadian dollars or that borrowing in foreign currency be swapped into Canadian dollars. The primary source of interest rate risk is repricing risk which arises when there is a mismatch between the maturity and repricing of interest bearing assets and liabilities. This repricing risk also results from the Authority's willingness to allow for some prepayments on existing loans.

The prepayment policy is structured to protect the Authority from the significant losses that would occur in accepting additional prepayments of high interest rate loans and relending these funds at lower rates. The Authority, on three separate occasions, has reduced the rates on higher interest rate loans to 12%. The Authority does not have the ability to prepay or refinance its public debt and can only repay the Canada Pension Plan Investment Fund at current market rates which would not make it economically advantageous. The Authority's prepayment policy is an integral part of its long-term financial planning.

Interest Rate Risk

The Authority uses mainly interest rate swaps for the purpose of managing its asset and liability position. The Authority's policy is to match the interest rate exposure on all new loans to the interest rate exposure of the debt used to fund these loans. In most cases, both interest on new loans and debt are swapped to floating.

The Board recognizes the unique risks associated with the use of derivative financial instruments and has established policies and procedures to monitor and minimize exposure to the Authority. These policies and procedures limit the type of derivative financial instruments and circumstances where they can be used, the authorities required to approve the transaction and the appropriate segregation of duties to reduce operational risk. All derivative financial instruments are reviewed and managed within policies approved by the Board and the Board reviews all derivative financial instruments made since the last meeting.

Credit risk on counterparty default arises with the use of derivatives. To control this risk, the Authority uses counterparty limits established for the Province and uses only counterparties believed to be credit worthy. The Authority is not exposed to credit risk for the full face value (notional amount) of the derivative contracts, but only to the potential replacement cost if the counterparties fail. This exposure is represented by the current replacement cost of all outstanding contracts in a favourable position. For additional information, see Note 8 in the Financial Statements.

Liquidity Risk

Liquidity risk is the risk that the Authority will not have sufficient cash to meet its obligations as they become due and also meet the loan requirements of our local authorities.

The Authority manages its liquidity risk by monitoring its cash flows on a daily basis and providing updated cash flow reports to the Board as required. Surplus funds are invested in short-term investments or the Consolidated Cash Investment Trust Fund. When required, the Authority raises funds under a five-year Promissory Note Program, by direct borrowing in the Canadian or European market or by renewing borrowing from the Canada Pension Plan Investment Fund.

Operational Risk

Operational risk is the risk associated with a breakdown in internal controls, systems or procedural failures, human errors or malfeasance. These risks can never be fully eliminated but are minimized by establishing appropriate policies and sound internal controls through an appropriate segregation of duties, accountability and reporting practices.

The examination of the financial statements was made in accordance with Canadian generally accepted auditing standards and, accordingly, included a review of certain of the systems of operating and financial controls and such tests that were considered necessary in the circumstances.

The objective of a financial statement audit is to obtain reasonable assurance whether the financial statements are free of material misstatement. Accordingly, an audit would not usually identify all such matters that may be of interest to management and the Board of Directors, however any weaknesses in internal controls or other non-trivial matters are communicated to management and the Board of Directors.

Credit Risk

Credit risk is the risk of loss due to a borrower failing to meet their obligations to the Authority. Historically, the Authority has not been required to record any provisions or allowances regarding credit losses nor has it suffered any such losses. The Authority has established policies which provide for the approval and monitoring of all lending activity. These policies include establishing clear lines of authority for decision making and for accountability.

Financial Reporting Responsibility of Management

Management of the Alberta Capital Finance Authority prepared these financial statements and is responsible for their reliability, completeness and integrity. They conform in all material respects to Canadian generally accepted accounting principles and the requirements of the *Alberta Capital Finance Authority Act*.

Management maintains the necessary accounting and internal control systems designed to ensure the timely production of reliable and accurate financial information, the protection of assets (to a reasonable extent) against loss or unauthorized use and the promotion of operational efficiency. The Board of Directors oversees management's responsibilities for financial reporting and internal control systems.

The Auditor General of Alberta is designated as the external auditor in the *Alberta Capital Finance Authority Act*. The Board of Directors reviewed these financial statements with the external auditor in detail before their approval.

[Original Signed]

FCA
President

Edmonton, Alberta
January 27, 2006

Auditor's Report

To the Shareholders of the Alberta Capital Finance Authority

I have audited the balance sheet of the Alberta Capital Finance Authority as at December 31, 2005 and the statements of loss and retained earnings and cash flow for the year then ended. These financial statements are the responsibility of the Authority's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Authority as at December 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

[Original Signed]

FCA
Auditor General

Edmonton, Alberta
January 27, 2006

Balance Sheet

as at December 31, 2005
(thousands of dollars)

	2005 Budget	2005 Actual	2004 Actual
Assets:			
Cash (Note 3)	$ 91,590	$ 10,304	$ 23,025
Accrued interest receivable	103,246	109,662	121,988
Loans to local authorities (Note 4)	3,894,136	4,293,356	4,135,820
	$ 4,088,972	$ 4,413,322	$ 4,280,833
Liabilities and Shareholders' Equity:			
Liabilities:			
Accrued interest payable	$ 48,324	$ 53,751	$ 56,329
Debt (Note 5 and Schedule 1)	4,032,065	4,347,834	4,211,776
	4,080,389	4,401,585	4,268,105
Shareholders' Equity:			
Share capital (Note 6):			
Issued and fully paid:			
6,378 shares (2004 - 6,376)	64	64	64
Retained earnings	8,519	11,673	12,664
	8,583	11,737	12,728
	$ 4,088,972	$ 4,413,322	$ 4,280,833

The accompanying notes are part of these financial statements.

[Original Signed]

D.O. Lussier
Chair of the Board

[Original Signed]

T.S. Stroich, FCA
President

Statement of Loss and Retained Earnings

for the year ended December 31, 2005
(thousands of dollars)

	2005 Budget	2005 Actual	2004 Actual
Interest Income:			
Loans	$ 276,985	$ 277,000	$ 298,412
Amortization of loan discounts	6,424	6,424	9,175
Other	3,600	2,594	2,815
	287,009	286,018	310,402
Interest Expense:			
Debt	288,699	285,312	319,704
Amortization of net discounts on debt	661	796	1,378
	289,360	286,108	321,082
Net interest expense	(2,351)	(90)	(10,680)
Other Income:			
Loan prepayment fees	–	66	1,577
Net interest expense and other income	(2,351)	(24)	(9,103)
Non-Interest Expense:			
Administration and office expenses (Note 7)	649	967	639
Net loss	(3,000)	(991)	(9,742)
Retained earnings, beginning of year	11,519	12,664	22,406
Retained earnings, end of year	$ 8,519	$ 11,673	$ 12,664

Statement of Cash Flow

for the year ended December 31, 2005
(thousands of dollars)

	2005		2004
	Budget	Actual	Actual
Operating Activities:			
Interest received	$ 289,878	$ 289,326	$ 304,613
Other interest	3,600	2,594	2,815
Loan prepayment fees	–	66	1,577
Administration and office expenses	(649)	(967)	(639)
Interest paid	(291,830)	(287,890)	(316,021)
Cash flows from (used in) operating activities	999	3,129	(7,655)
Investing Activities:			
Loan repayments	497,174	500,825	397,916
New loans issued	(250,000)	(651,937)	(607,463)
Cash flows from (used in) investing activities	247,174	(151,112)	(209,547)
Financing Activities:			
Debt issues	253,993	967,866	713,410
Debt redemptions	(433,365)	(832,604)	(475,491)
Cash flows from (used in) financing activities	(179,372)	135,262	237,919
Net (decrease) increase in cash	68,801	(12,721)	20,717
Cash, beginning of year	22,789	23,025	2,308
Cash, end of year	$ 91,590	$ 10,304	$ 23,025

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

(all amounts presented in thousands of dollars, except share amounts)

1. **Authority**
   The Alberta Capital Finance Authority operates under the authority of the *Alberta Capital Finance Authority Act*, Chapter A-14.5, Revised Statutes of Alberta 2000, as amended.

2. **Significant Accounting Policies and Reporting Practices**
   These financial statements have been prepared by management in accordance with Canadian Generally Accepted Accounting Principles (GAAP) and include the following significant accounting policies:

   a) **Debt**
   Debt premiums and discounts, including underwriting commission, arising on the issue of debt are deferred and amortized over the term of the debt.

   Debt is recorded net of unamortized premiums or discounts.

   Public debt issue expenses are charged against income as they are incurred.

   b) **Discounts on Loans to Local Authorities**
   Discounts are recorded for reductions of interest rates given on loans to local authorities with interest rates above a certain level and are amortized to income over the term of these loans. Annual amortization is the change in the present value of the remaining interest rate reduction.

   c) **Measurement Uncertainty**
   The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the year. Actual results could differ from these estimates. Measurement uncertainty exists in the valuation of the loans to local authorities and the estimate of fair value of financial instruments.

   d) **Credit Risk**
   Credit risk is the risk of loss due to borrowers failing to meet their obligations to the Authority. Historically, the Authority has not needed to record any provisions or allowances regarding credit losses nor has it suffered any such losses. The Authority has established policies which provide for the approval and monitoring of all lending activity. These policies include establishing clear lines of authority for decision making and for accountability.

   e) **Derivative Financial Instruments**
   Derivative financial instruments used by the Authority are interest rate contracts whose value is derived from interest rates and are used to accommodate the management of risk for asset/liability management purposes and to manage the Authority's interest rate exposure.

   To designate a derivative financial instrument as a hedge for accounting purposes, the criteria of Accounting Guideline 13, Hedging Relationships must be met. In order to qualify for hedge accounting, the Authority formally documents all relationships between hedging instruments and hedging items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivative financial instruments to specific assets and liabilities. The Authority also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative financial instruments that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

   Derivative financial instruments are accounted for on an accrual basis. Income and expenses on derivative financial instruments designated and qualifying as hedges are recorded as an adjustment to the yield of the item being hedged over the term of the hedge contract in the Statement of Loss and Retained Earnings.

Accrued interest receivable and payable on these derivative financial instruments are recorded in accrued interest receivable and payable respectively, in the Balance Sheet.

If the hedge is no longer effective, the associated derivative financial instrument is subsequently carried at fair value on the Balance Sheet and the fair value and any subsequent changes to the fair value are recorded in the Statement of Loss and Retained Earnings in other income.

Derivative financial instruments that have been acquired for asset/liability management purposes that do not qualify for hedge accounting are carried at fair value on the Balance Sheet and the fair value and any subsequent changes in the fair value are recorded in the Statement of Loss and Retained Earnings in other income.

Accrued income and expenses and deferred gains and losses are included in other assets and other liabilities as appropriate in the Balance Sheet.

3. **Cash**

Cash is on deposit in the Consolidated Cash Investment Trust Fund of the Province of Alberta which is managed with the objective of providing competitive interest income to depositors while maintaining appropriate security and liquidity of depositors' capital. The portfolio is comprised of high-quality short-term and mid-term fixed-income securities with a maximum term-to-maturity of three years. As at December 31, 2005, securities held by the Fund have an average effective market yield of 3.62% per annum (December 31, 2004: 2.64% per annum).

4. **Loans to Local Authorities**

	2005	2004
Loans to local authorities	$ 4,301,317	$ 4,150,205
Less: Unamortized discounts	7,961	14,385
	$ 4,293,356	$ 4,135,820

5. **Debt**

(a) The debt of the Authority is fully guaranteed by the Province of Alberta.

(b) Debt amounting to $1,920,963 (2004 - $2,204,567) held by the Canada Pension Plan Investment Fund (CPPIF) is redeemable at the option of the Minister of Finance of Canada by giving six months notice in writing and observing the other redemption provisions of the debt agreement.

(c) Debt amounting to $565,000 (2004 - $302,000) is comprised of a combination of various issues of step-up and accrual notes whereby the Authority has the option of extending or calling the debt, at predetermined extension or call dates. Principal is due upon termination of the debt, where debt is called or not extended by the Authority at the predetermined extension or call date, or upon final maturity of the debt (Schedule 1).

(d) For the next five years debt redemption requirements, with the assumption that the step-up and accrual notes are redeemed at the first extendible date and all other debt at the maturity date, are as follows:

	Debt Redemption
2006	$ 950,396
2007	345,383
2008	259,294
2009	330,523
2010	200,000
	$ 2,085,596

6. Share Capital

Particulars of share capital are as follows:

Class	Restricted to	Number of Shares: Authorized	Number of Shares: Issued and Fully Paid	Total Dollar Amount
A	Province of Alberta	4,500	4,500	$ 45,000
B	Municipal authorities, airport and health authorities	1,000	860	8,600
C	Cities	750	585	5,850
D	Towns and villages	750	296	2,960
E	Educational authorities	500	137	1,370
		7,500	6,378	$ 63,780

During the year, one Class B, three class C and one Class E shares were issued and three Class D shares were cancelled at $10.00 each.

7. Directors' Fees and Related Party Transactions

Directors' fees paid by the Authority are as follows:

	2005		2004	
	Number of Individuals	Total	Number of Individuals	Total
Chair of the Board	1	$ 6	1	$ 5
Board members	6	$ 16	6	$ 18

There are two additional Board members who are employees of the Province of Alberta and do not receive compensation from the Authority.

The Authority has advanced loans to local authorities under the ME *first!* Municipal Energy Efficiency Assistance program (the "Program") on behalf of Alberta Municipal Affairs and Alberta Environment. Under the Program, principal is advanced to qualifying municipalities by the Authority and repayments of principal are made by the municipality; however, the interest is paid by the Province of Alberta. Included in the balance of loans to local authorities at December 31, 2005 is principal of $12,978 (2004 - $5,536), upon which, interest of $188 (2004 - $122) has been recorded in interest income from loans.

The Authority has no employees. Included in administration and office expenses of $967 (2004 - $639) is the amount of $417 (2004 - $331) that was paid to the controlling shareholder, Province of Alberta for goods and services at prices which approximate market.

8. Derivative Financial Instruments

Derivative financial instruments used by the Authority include interest rate swaps and forward rate agreements. The Authority enters into derivative financial instruments for risk management purposes and does not act as an intermediary in this market.

The interest rate contracts are used to manage exposure to fluctuations in interest rates in certain fixed rate loans and related debt made after January 1, 2004.

NOTES TO THE FINANCIAL STATEMENTS
(continued)

Notional amounts represent the amount to which a rate is applied in order to calculate the exchange of cash flows. The notional amounts are not recorded in the Balance Sheet. They represent the volume of outstanding transactions and do not represent the potential gain or loss associated with the market risk or credit risk of such instruments.

The notional amounts of derivative financial instruments are summarized as follows:

As at December 31

Maturities	Within 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	Over 10 Years	Total
Interest rate contracts						
Interest rate swaps - 2005	$ 449,000	$ 21,380	$ 102,477	$ 419,070	$ 1,342,707	$ 2,334,634
Interest rate swaps - 2004	$ 302,000	$ -	$ 46,713	$ 162,251	$ 647,196	$ 1,158,160

The cost of replacing the remaining cash flows of the derivative financial instruments at the prevailing prices and market rates are summarized as follows:

As at December 31

			Current Replacement Cost	
	Notional Outstanding	Net Fair Value	Favourable Position	Unfavourable Position
Interest rate contracts				
Interest rate swaps - 2005	$ 2,334,634	$ (12,393)	$ 27,802	$ (40,195)
Interest rate swaps - 2004	$ 1,158,160	$ (3,595)	$ 12,308	$ (15,903)

Fair values are determined using pricing models which take into account current market and contractual prices of the underlying instruments, as well as time value and yield curve or volatility factors underlying the positions. Fair values have been segregated between those contracts which are in a favourable position (positive fair value) and those contracts which are in an unfavourable position (negative fair value).

Current credit exposure is limited to the amount of loss that the Authority would suffer if every counterparty to which the Authority was exposed were to default at once and is represented by the current replacement cost of all outstanding contracts in a favourable position. The Authority actively monitors their exposure and minimizes credit risk by only dealing with counterparties believed to be credit worthy.

9. Interest Rate Risk

Interest rate risk refers to the potential impact of changes in interest rates on the Authority's earnings when maturities of its financial assets are not matched with the maturities of its financial debt. The following table summarizes the carrying amounts of the Authority's interest sensitive assets and liabilities based on the earlier of contractual repricing or principal repayments:

As at December 31

Maturities	Within 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	Over 10 Years	2005 Total	2004 Total
Assets							
Cash	$ 10,304	$ –	$ –	$ –	$ –	$ 10,304	$ 23,025
Accrued Interest Receivable	109,662	–	–	–	–	109,662	121,988
Loans	390,354	444,778	1,055,479	1,128,168	1,282,538	4,301,317	4,150,205
Effective Rate	7.0%	6.9%	6.6%	6.1%	5.7%	6.4%	7.2%
Total	$ 510,320	$ 444,778	$ 1,055,479	$ 1,128,168	$ 1,282,538	$ 4,421,283	$4,295,218
Liabilities							
Accrued Interest Payable	$ 53,751	$ –	$ –	$ –	$ –	$ 53,751	$ 56,329
Debt	950,396	345,383	789,817	1,250,000	1,020,367	4,355,963	4,216,567
Effective Rate	7.4%	6.9%	6.1%	5.7%	5.5%	6.3%	6.9%
Total	$1,004,147	$ 345,383	$ 789,817	$ 1,250,000	$ 1,020,367	$ 4,409,714	$4,272,896
Net Gap	$ (493,827)	$ 99,395	$ 265,662	$ (121,832)	$ 262,171	$ 11,569	$ 22,322

The Authority manages on a continuous basis its interest rate risk by matching its debt maturity profile to the forecast cash flows and their effect on the Authority's surplus position. For most loans made after January 1, 2004, the Authority uses derivative financial instruments to swap fixed rate loans interest to floating, and swap corresponding debt from fixed rate to floating and uses forward rate contracts to minimize the exposure related to the mismatch of reset dates of the loan and debt swaps.

10. Fair Value of Financial Instruments

The amounts set out in the table represent the fair value of the Authority's financial instruments based on the following assumptions and valuation methods.

Fair value represents the estimated consideration that would be agreed upon in a current transaction between knowledgeable, willing parties who are under no compulsion to act. For loans and debt, fair value is calculated using net present value techniques where the Authority's future cash flows are discounted at the Authority's current cost of funds.

Changes in interest rates are the main cause of changes in the fair value of the Authority's financial instruments.

The fair value of cash approximates its carrying value.

The following table presents the financial instruments with a carrying value different from the fair value at December 31:

	2005		2004	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Loans, including accrued interest receivable	$ 4,826,948	$ 4,403,018	$ 4,737,552	$ 4,257,808
Debt, including accrued interest payable	$ 4,772,766	$ 4,401,585	$ 4,704,483	$ 4,268,105

Fair value of derivative financial instruments is provided in Note 8.

11. Commitments

Lease
The Authority has obligations under an operating lease for the rental of premises at an annual minimum amount of $25, expiring in July 2008.

Credit Commitments
In the normal course of business, the Authority enters into loan commitments to provide customers with sources of credit.

Commitments to extend credit represent undertakings to make credit available in the form of loans for specific amounts and maturities, subject to certain conditions and are recently authorized loans not yet drawn down.

These loan arrangements are subject to the Authority's normal credit standards and collateral is obtained where appropriate. The loan amounts represent the maximum credit risk exposure to the Authority should the loans be fully drawn. These arrangements will most likely be drawn upon; the loan amounts represent future cash requirements. Loan commitments as at December 31 were:

	2005	2004
Loan commitments as at December 31	$ 17,381	$ 28,600

12. Budget
The 2005 budget was approved by the Board of Directors on December 3, 2004.

13. Comparative Figures
Certain comparative figures have been reclassified to conform with the current year presentation.

Schedule of Debt

As at December 31, 2005
(thousands of dollars)

Schedule 1

Maturity Date	First Extendible Date	Interest Rate	Principal Outstanding
Canada Pension Plan Investment Fund (Note 5(b))			
Nov 03, 2006		9.850	$ 395,396
Nov 02, 2007		9.660	335,383
Oct 03, 2008		10.040	259,294
Oct 02, 2009		9.990	291,414
Nov 01, 2009		9.620	32,457
Dec 01, 2009		9.260	6,652
Oct 01, 2020		6.280	222,367
Jun 01, 2022		6.060	100,000
Apr 05, 2023		5.890	50,000
Dec 01, 2023		5.500	150,000
Dec 03, 2024		5.180	78,000
Total			1,920,963
Public			
Mar 24, 2008	Mar 24, 2006	3.000	16,000 (i)
Mar 01, 2010		4.550	50,000
Aug 20, 2010		4.500	150,000
Jun 23, 2011	Jun 23, 2006	3.000	10,000 (i)
Sep 01, 2011		5.700	200,000
Sep 15, 2011	Sep 15, 2006	3.500	10,000 (i)
Dec 15, 2011		4.435	50,000
Dec 15, 2011	Dec 15, 2006	3.300	13,000 (i)
May 11, 2012	May 11, 2006	3.250	10,000 (i)
Jun 01, 2012		5.850	500,000
Jun 28, 2013	Jun 28, 2006	3.500	15,000 (i)
Oct 12, 2013	Oct 12, 2006	3.250	10,000 (i)
Dec 02, 2013		5.000	300,000

Maturity Date	First Extendible Date	Interest Rate	Principal Outstanding
Public (continued)			
Dec 15, 2014	Jun 15, 2006	4.000	25,000 (i)
Dec 15, 2014	Jun 15, 2006	4.300	30,000 (i)
Mar 23, 2015	Mar 23, 2006	4.250	20,000 (ii)
Mar 30, 2015	Mar 30, 2006	4.050	15,000 (i)
Apr 06, 2015	Apr 06, 2006	4.150	15,000 (i)
Jun 01, 2015		4.900	200,000
Jun 15, 2015	Jun 15, 2006	4.000	10,000 (i)
Jun 15, 2015	Jun 15, 2006	4.100	45,000 (i)
Jun 15, 2015	Jun 15, 2006	4.000	17,000 (i)
Jun 15, 2015	Jun 15, 2006	3.250	15,000 (i)
Jun 23, 2015	Jun 23, 2006	3.700	15,000 (ii)
Jun 28, 2015	Jun 28, 2006	4.300	20,000 (ii)
Sep 15, 2015	Sep 15, 2006	4.240	10,000 (ii)
Dec 15, 2015	Jun 15, 2006	4.150	20,000 (i)
Jun 15, 2016	Jun 15, 2006	4.000	25,000 (i)
May 15, 2017	May 15, 2006	4.000	25,000 (i)
Jun 16, 2017	Jun 16, 2006	4.000	18,000 (i)
Jun 28, 2017	Jun 28, 2006	4.000	30,000 (i)
Aug 15, 2017	Aug 15, 2006	4.000	35,000 (i)
Dec 15, 2017	Dec 15, 2007	4.000	10,000 (i)
Jun 01, 2018		5.150	100,000
Dec 01, 2023		5.100	20,000
Jun 15, 2025	Jun 15, 2006	5.150	20,000 (ii)
Jul 06, 2025	Jul 06, 2006	5.020	16,000 (ii)
Dec 15, 2025		4.450	300,000
Oct 11, 2030	Oct 11, 2006	5.160	15,000 (ii)
Dec 15, 2030	Dec 15, 2006	5.160	10,000 (ii)
Dec 15, 2030	Dec 15, 2006	5.410	10,000 (ii)
Dec 15, 2030	Dec 15, 2006	5.400	10,000 (ii)
Total			2,435,000
			4,355,963
Net unamortized discount			8,129
Total debt 2005			$ 4,347,834
Total debt 2004			$ 4,211,776

(i) These are step-up notes extendible at the Authority's option which pay interest periodically at a predetermined rate with principal paid on termination.

(ii) These are accrual notes extendible or callable at the Authority's option which accrue interest semi-annually or annually and pay interest and principal on termination.